



**Comment to the President's National Commission on Fiscal Responsibility and Reform (NCFRR)  
in response to  
The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation  
from the President's Economic Recovery Advisory Board (PERAB)**

**Submitted by the Affordable Housing Tax Credit Coalition  
November 24, 2010**

**Introduction and Overview**

The Affordable Housing Tax Credit Coalition (Coalition) appreciates this opportunity to comment on the Report on Tax Reform Options from the President's Economic Recovery Advisory Board (PERAB). While we understand that the report does not represent official Administration policy and is meant to explore possible tax reform options, we disagree with suggestions that the Low Income Housing Tax Credit (Housing Credit) should be considered for repeal. The Coalition is group of syndicators, developers, lenders, nonprofit groups, public agencies, and others concerned with the Housing Credit.

We encourage the NCFRR to support the Housing Credit when drafting its tax-related recommendations. The Housing Credit is itself a result of tax reform. Congress enacted it as section 42 of the Internal Revenue Code in the Tax Reform Act of 1986. Prior to the Act, the Code contained various provisions to encourage investment in rental housing properties. These included accelerated depreciation schedules, five-year amortization of rehabilitation expenses and expensing of construction period interest and taxes, as well as capital gains and passive loss allowances. These tax provisions were widely regarded as inefficient and poorly targeted. Taxpayers could claim their full value even if only 20 percent of the apartments in tax-subsidized properties served low-income renters, while up to 80 percent rented at market rates: tenant income targets were considered too high; the 15-year affordability term was too short; incentives discouraged serving families with children, for whom affordable housing is especially scarce; and compliance monitoring was limited.

In enacting the Housing Credit in the context of comprehensive tax reform Congress affirmed the importance of encouraging the private market to help provide affordable rental housing through the tax code, while demanding greater public benefit for the federal expenditure. Through the past 24 years the Housing Credit has demonstrably exceeded congressional objectives.

"The Low-Income Housing Tax Credit (LIHTC) program is widely regarded as the most successful affordable housing production and preservation program in the nation's history," according to Harvard University's Joint Center for Housing Studies<sup>1</sup>. The Housing Credit is a highly effective and efficient public policy. Through a competitive allocation process, only those developments most responsive to federal and state housing priorities are receive Housing Credits, and only the minimum amount reasonably required for financial feasibility. Only the low-income targeted apartments within a development are eligible for Housing Credits. It is a pay-for-performance policy, since credits can be claimed only after the apartments are completed and leased to genuinely low-income tenants (including families with children) at affordable rents. Targeted apartments must remain occupied and in good condition for at least 30 years and in some cases much longer, and Housing Credits are subject to recapture for 15 years. Compliance is closely monitored and extremely high. Housing Credit properties outperform other classes of real estate, with aggregate annualized foreclosure rates below 0.1 percent since 1987, according to Ernst & Young.<sup>2</sup>

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<sup>1</sup> Joint Center for Housing Studies of Harvard University, "The Disruption of the Low-Income Housing Tax Credit Program: Causes, Consequences, Responses, and Proposed Correctives," December 2009, p. 13.

<sup>2</sup> Ernst & Young, *Understanding the Dynamics IV: Housing Tax Credit Investment Performance*, 2009, p. 3.

The Housing Credit is the backbone of federal policies to develop and preserve affordable rental housing policy. The Housing Credit is involved in the vast majority of affordable housing production and preservation, and is the foundation upon which other federal policies are built. The Housing Credit is also the model for federal policies attracting private investment for other purposes, such as the highly successful New Markets Tax Credit.

Finally, in addition to affordable rental housing, building or rehabilitating each 100 Housing Credit apartments generates 116 jobs and more than \$3.3 million in federal, state and local revenue, important considerations especially in these difficult economic times, according to the National Association of Home Builders.<sup>3</sup>

We have organized our comment to address: the need for affordable rental housing; an explanation of the Housing Credit and its effectiveness and efficiency; and two issues PERAB had raised, neighborhood revitalization and cost-effectiveness relative to Housing Choice Vouchers program.

### **The Need for Affordable Rental Housing**

There is currently a substantial short-fall of affordable rental housing nationwide, which is likely to widen over the next several years. Although the rental housing market overall has significant vacancy rates, these vacancies predominate at the upper end of the market, appear to be the temporary artifact of the recession, and are generally not convertible to affordable housing, especially over the long term. The intermediate- and long-term market outlook suggests significant rental housing shortages of 3.8 – 5.0 million units from 2011 through 2020, according to Harvard University’s Joint Center for Housing Studies.<sup>4</sup>

- While overall rental vacancy rate is 10.6 percent, most of these vacancies are among the higher rent stock, and the rate among Housing Credit properties is a much lower 4.2 percent. Vacant upper-end property owners have not been reducing rents significantly so they can preserve their upper-end market niches. Lenders are similarly reluctant to force down-marketing that would impair collateral. Anecdotal evidence suggests that rents in some markets are beginning to rise significantly, indicating that vacancies are dropping.
- “The erosion of [rental housing] affordability over the last 50 years is striking,” reports Harvard. “In 1960, only 12 percent of renter households spent half or more of their incomes on housing. By 2008, that share had doubled. In 1960, half of renters in the bottom income quartile spent 39 percent or less of their incomes on housing. In 2008, half spent 54 percent or more.”<sup>5</sup> Currently, 46 percent of all renters pay more than 30 percent of their income on housing, the most common affordability threshold.<sup>6</sup> Recent data from the Census Bureau found a huge shortfall in the supply of homes for extremely low-income people. Analysis of these data found that there were only 37 units of housing affordable and available for every 100 extremely low-income households in the country, representing a national shortage of over 2 million units.<sup>7</sup> We wish to stress that shortfalls in affordable housing began long before the recent recession and will continue long after recovery.

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<sup>3</sup> Liu, Helen Fei and Paul Emrath. “The Direct Impact of Home Building and Remodeling on the U.S. Economy,” National Association of Home Builders, October 7, 2008

<sup>4</sup> Joint Center for Housing Studies of Harvard University, “State of the Nation’s Housing 2010” (2010), p. 26.

<sup>5</sup>Ibid., p. 28.

<sup>6</sup>Ibid., p. 38.

<sup>7</sup> National Low Income Housing Coalition, September 2010.

- The recession has aggravated the problem. In the immediate term, declining household incomes has worsened affordability. Moreover, several recessionary forces are deepening the long-term shortfalls in the broad rental housing market. (1) Multifamily construction starts have fallen to about one-third of historical levels for the last two years, an aggregate shortfall of 400,000 units below normal production. (2) Even as rental housing demand increases, financing for multifamily construction is constrained, in part because construction lenders cannot be sure that permanent financing will be available when construction is completed two years later, in light of the uncertain future of Fannie Mae and Freddie Mac and the curtailment of new multifamily mortgage backed securities. (3) Household formation has slowed considerably and is likely to surge as the economic recovery takes hold, adding to demand-side pressure.
- Long-term demographic trends should also contribute to a rental housing shortfall. Three components of increasing demand are: (1) growth among elderly households, which tend to rent more than middle-aged households, as the baby boom generation retires; (2) growth among the “echo boom” generation of young adults, also a demographic that favors rental housing; and (3) new immigrants. In addition, stagnant household incomes, reduced home equity, tighter home mortgage standards, and lower expectations for home price appreciation are reducing home buying, shifting demand to rental housing generally and especially among low- and moderate-income households. We see little hope that the broader rental housing market will accommodate widespread filtering to accommodate low-income households.

### **Housing Credits: Effectiveness and Efficiency**

The purpose of the Housing Credit is to enable the private market to provide newly constructed and rehabilitated rental homes that low-income families and individuals can afford. According to a Government Accountability Office (GAO) report reviewing the program: “In establishing the tax credit incentive, Congress recognized that a private sector developer may not receive enough rental income from a low-income housing project to (1) cover the cost of developing and operating the project, and (2) provide a return to investors sufficient to attract the equity investment needed for development.”<sup>8</sup>

The Housing Credit provides taxpayers – predominately large, sophisticated corporations – a federal income tax credit for investments in rental housing developments serving low-income families for no less than 30 years. The amount of tax credit is based on a percentage of eligible development costs and claimed over a ten-year period. Tax credits can only be claimed with respect to costs incurred to finance housing for low-income families at affordable rents and in good condition. In general, Housing Credit-assisted homes must be rented to tenants whose income does not exceed 60 percent of area median income (AMI). By way of illustration, 60 percent of the national median household income for a family of three is roughly \$27,000 according to the Census Bureau’s American Community Survey data released in September. This income level varies significantly by area.

The Housing Credit is highly *effective*.

- First and foremost, it does what Congress intended it to do: generate private capital investment to support development and rehabilitation of new and rehabilitated affordable rental homes for low-income families. As the nation’s largest and most successful affordable rental housing production program, the Housing Credit program has financed more than two million apartment homes since 1987 and about 120,000 annually before the recession. No discernable new affordable rental housing is built without substantial public subsidy and, according to the National Council of State Housing Agencies, approximately 90 percent of all affordable rental housing is financed annually through the Housing Credit.

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<sup>8</sup> General Accounting (now Government Accountability) Office, *Tax Credits: Opportunities to Improve Oversight of the Low Income Housing Program*, March 1997, p. 22.

- Until the recent financial crisis dampened investments, the program was generating about 140,000 jobs annually and \$1.5 billion in state and local taxes and other revenues according to the National Association of Home Builders (NAHB). Even at reduced levels of investment and production, the Housing Credit represented half of all multifamily starts in 2010<sup>9</sup>, also according to NAHB. This demonstrates that the program is keeping capital flowing for multifamily housing, as well as keeping the many types of small businesses in the construction industry—architects, engineers, plumbers, electricians, carpenters, concrete fabricators, bricklayers, roofers, and other specialties—in business and their employees employed. In recent months the Housing Credit investment market has regained significant strength.
- In practice the Housing Credit serves much lower income tenants on average than the law requires. The GAO found that Housing Credit renters earn on average 37 percent of their AMI.<sup>10</sup> GAO found, and other evaluations have confirmed, that nearly 40 percent of Housing Credit renters have incomes of 30 percent or less of AMI and three quarters earn 50 percent or less of AMI. Thirty percent of AMI and below is considered extremely low-income with respect to federal housing programs. On a national basis, this income level is about \$13,500 annually. Fifty percent of AMI and below is considered very low-income and is approximately \$22,500 annually. The GAO found that Housing Credit apartment rents were well below market rents (on average 25 percent less than the HUD’s “fair market rent”) and that Housing Credit properties were well maintained.
- The Housing Credit brings well-designed, affordable rental housing to a wide variety of communities—from inner cities to rapidly growing suburbs to rural towns. It builds new affordable apartments and saves valuable at-risk existing affordable housing. It provides affordable homes to working families and vulnerable populations with special needs—the elderly, people with disabilities, and the homeless. It addresses the housing needs of acutely underserved communities, such as farmworkers and Native Americans, and it is the key housing resource for transformative community redevelopment and revitalization efforts nationwide.
- Only those projects that serve the highest federal and state housing priorities receive Housing Credits. States award tax credits to developers under a public, competitive process in accordance with annual plans states develop with public input that reflect their affordable housing needs. These plans are required by statute to give preference to developments serving the lowest income residents, developments that serve income-qualified residents for the longest periods, and to developments in distressed areas that are part of a community revitalization plan. Applications greatly exceed the volume of available Housing Credits in most states.
- Housing Credit properties have performed very well, with an extremely low annual foreclosure rate below 0.1 percent since 1987, according to an exhaustive study by Ernst & Young. This performance compares very favorably with other classes of real estate. States are required to ensure that Housing Credit apartments remain in good condition and in compliance with tenant income and rent rules for at least 30 years. States report instances of noncompliance to the IRS, which has the ability to recapture tax credits.

The Housing Credit is also highly *efficient*.

- Sophisticated corporate investors compete for developments that receive Housing Credit allocations. (Individual investors comprise a tiny share of the market.) As investors bid more for the tax credits, the government realizes more public benefit for each dollar of tax expenditure. Strong “purchasing power”

<sup>9</sup> Crowe, David, *Housing and Economic Outlook*, National Association of Home Builders, September 16, 2010.

<sup>10</sup> General Accounting (now Government Accountability) Office, *Tax Credits: Opportunities to Improve Oversight of the Low Income Housing Program*, March 1997, p. 41.

for the Housing Credit (efficiency for the federal government) also makes the credit more effective at achieving its public purpose. Although the recession caused Housing Credit equity pricing to drop from 2009 through early 2010, pricing has recovered considerably over the last several months, though it remains uneven in some parts of the country.

- The Housing Credit does not support activity that would have otherwise occurred. States review applications for Housing Credits at three points in the application and development process and are required to allocate only as much Housing Credit as a proposed development needs to be financially viable. Investors with money at risk also intensively review and monitor Housing Credit properties. Strong oversight and accountability enforced by the private sector is a distinguishing feature of the Housing Credit. This is a function of its structure as a tax provision, and unlikely to be replicable in capital grant programs. In addition, since investors can claim the Credit only as units are completed, occupied by qualifying tenants at affordable rents, and meet physical condition and habitability standards, the private sector takes all the development and marketing risk associated with the credit, whereas in a capital grant subsidy, the government assumes the risk.
- The federal government allows Housing Credits only for successful housing that meets federal requirements. Taxpayers may only claim the credits, at the risk of recapture by the IRS for 15 years, if Housing Credit-financed developments remain affordable to qualified low-income renters and in good condition for the long term. States enforce compliance for at least 30 years.
- The Housing Credit leverages other private capital in addition to investor equity. The Housing Credit was specifically designed *not* to provide the entire amount of financing; the Housing Credit leverages private debt to cover a portion of the total development costs of Housing Credit housing. Lenders are more inclined to finance Housing Credit properties because of the presence of Housing Credit investors.

### **Neighborhood Revitalization**

The PERAB report cites the Housing Credit's contribution to neighborhood revitalization, an Administration policy goal. We strongly agree, and we further suggest that the Housing Credit is also central to other federal policy goals.

As practitioners, we have seen that Housing Credit investments often catalyze a broader neighborhood revitalization process, replacing blight with attractive assets, demonstrating that improvement is possible and sustainable in communities that have suffered disinvestment, encouraging neighboring property owners to improve their properties, attracting homeowners, and enhancing the market for retailers.

Academic research is consistent with this experience. An extensive analysis of Housing Credit developments nationwide found the following:

Overall roughly half of the properties in the sample were developed primarily to serve neighborhood improvement goals. The vast majority of these were developed by nonprofit sponsors and undertaken to address a specific problem site in the neighborhood...Regardless of motivation, roughly two-thirds of the properties could be said to have had a substantial, positive impact on their neighborhoods.<sup>11</sup>

The remaining properties were found to have a moderate revitalization impact and some were in neighborhoods that did not need significant revitalization.

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<sup>11</sup> Buron, Nolden, Heintz, Stewart, *Assessment of the Economic and Social Characteristics of Housing Credit Residents and Neighborhoods*, Abt Associates, February 2000, pp. 6-11 - 6-12.

Furthermore, Housing Credit investment in high-poverty areas has helped bring families out of poverty and given them more economic opportunity, while improving the economic condition of their neighborhoods. A recent study analyzed the effects of Housing Credit housing on tenant income and home prices in neighborhoods located near all 660 New York City tax credit developments built between 1987 and 2003. The development of Housing Credit properties in low-income neighborhoods raised surrounding property values by 8.5 percent, a clear indication that the market perceived an improvement in neighborhood quality. In addition, Housing Credit rents were \$525 below neighborhood market rents, effectively doubling tenants' disposable income. Low rents enable Housing Credit tenants to pay for health care and other important family needs.<sup>12</sup>

In addition to neighborhood revitalization, the Housing Credit is the foundation for most other federal policies to produce or preserve affordable rental housing. These other policies would be more difficult and expensive to implement without the Housing Credit, and they would not benefit from private investor oversight.

### **Housing Credits and Vouchers**

The PERAB report notes that “some experts suggest other federal aid (like housing vouchers) would assist low-income households at a lower cost” than the Housing Credit. We support a balanced policy that supports both supply and demand for affordable rental housing as complementary, not as substitutes, and disagree that Housing Credits are more costly than vouchers.

- Housing Credits and Housing Choice Vouchers (vouchers) are both crucial to serving the nation's affordable housing needs and indeed, when combined, complement each other's strengths to address the nation's toughest housing challenges. Vouchers provide affordable housing choices to extremely low-income families, especially in low-cost housing markets. However, vouchers are not a replacement for the Housing Credit, which expands or preserves the affordable housing stock as a long-term community asset. Likewise, the Housing Credit, as a capital subsidy, cannot on its own ensure apartments are affordable to the very lowest income renters. Housing Credits and vouchers are often used together to address complementary problems: the Housing Credit to bring down the cost of the unit (on a long-term basis), and the voucher to enable that already low-cost unit to be affordable to the lowest income tenants (and at a much lower cost per voucher than if that same tenant rented in a conventional unit with a much higher rent).
- Especially in light of expected rental housing shortfalls, supply-side incentives for affordable apartments will continue to be important. Increasing demand without also increasing supply will only raise rents and thwart affordability. Virtually no affordable rental housing is built without subsidy, simply because affordable rents cannot support construction costs.
- It would be unrealistic to expect the federal government to expand the Housing Choice Voucher program significantly. The federal government will be looking for ways to cut spending, not take on substantial long-term obligations associated with additional vouchers.
- Vouchers cannot address several broad challenges for affordable rental housing, including: (1) recapitalizing and preserving aging properties, including federally assisted properties; (2) revitalizing low-income communities; (3) expanding supply in tight markets; (4) producing housing for large families and tenants with special needs, including the elderly, people with disabilities, and homeless; and (5) building housing near job growth areas. It is important to note that more than 40 percent of Housing

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<sup>12</sup> Walker, Christopher, *Affordable Housing for Families and Neighborhoods: The Value of Low Income Housing Tax Credits in New York City*, June 2010.

Credit units nationwide involve rehabilitation of existing properties and not new construction. The share appropriately varies among states according to local needs and market conditions.

Even though Housing Credits and Housing Choice Vouchers are more appropriately seen as complementary policy instruments than as substitutes, it is understandable that policy makers may want to compare costs among different programs. Perhaps counter-intuitively, it is probably not correct that building new Housing Credit apartments is more expensive than vouchers over the long term. The GAO conducted perhaps the most thorough cost comparison of federal housing programs, including Housing Credits and Housing Choice Vouchers in 2002, based on 1999 data<sup>13</sup>.

GAO initially found that federal costs over 30 years were somewhat higher for Housing Credits than for Housing Choice Vouchers based on 1999 data for metropolitan areas, where about 80 percent of the U.S. population resides. However, that conclusion rested on an assumption that rents would rise at a modest 3 percent annually. The cost differential virtually disappears if rents increase at 5 percent annually. The Center for American Progress concludes that “rents will in all likelihood rise, perhaps sharply, over the next ten years.”<sup>14</sup>

Moreover, the GAO analysis used a federal discount rate of 6 percent, but federal borrowing costs are now much lower, with the long-term Applicable Federal Rate calculated by the Treasury Department now at 3.35 percent (vs. 6.45 percent in January 2000). Long-term cost comparisons are sensitive to discount rates, and a lower discount rate would favor up-front capital subsidy instruments such as Housing Credits over ongoing subsidies such as vouchers. As such, Housing Credits are in all likelihood at least as cost effective as vouchers, and possibly more cost-effective.

### Conclusion

Although no tax expenditure increases tax code simplicity, the Housing Credit affects only the very limited number of predominately corporate investors that choose to use it and has virtually no impact on individual taxpayers. Because investors receive the tax credits only if the housing meets federal requirements, these taxpayers exercise oversight that furthers public policy objectives. This system has made the Housing Credit a highly effective and efficient public policy. Congress consciously chose to create the Housing Credit as part of comprehensive tax reform and voted in support of it on a bipartisan basis consistently since then.

We would also like to note that the Administration has stated its intent to rebalance federal housing policy away from its heavy emphasis on homeownership, which is most evident in tax policy. As many Administration officials have pointed out, rental housing is important too, especially for people not yet able or ready to buy. The deduction for home mortgage interest, which mostly benefits upper income homeowners, will cost the government \$120 billion in 2011 and \$573 billion between 2009 and 2013.<sup>15</sup> The Housing Credit, which serves very low-income renters, will cost \$5.1 billion in 2011 and \$30 billion between 2009 and 2013<sup>16</sup>—only 5 percent of the cost of the mortgage interest deduction over that period.

Some of the signature strengths of the Housing Credit summarized above are functions of the Housing Credit’s operation through the tax code. These include private sector underwriting, oversight and monitoring; competitive market-based pricing; high efficiency for the federal expenditure with low administrative costs; and powerful

<sup>13</sup> General Accounting (now Government Accountability) Office, *Federal Housing Assistance: Comparing the Characteristics and Costs of Housing Programs*. January 2002.

<sup>14</sup> Center for American Progress, *A Responsible Market for Rental Housing Finance*, October 2010, p. 1.

<sup>15</sup> Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013*, p. 33.

<sup>16</sup> *Ibid.*

penalties for non-compliance, which ensure that taxpayers do not bear the costs of non-compliance. These attributes are not commonly associated with government spending programs.

We urge the Commission to account for the importance of using tax policy on a carefully targeted, low-cost basis to help ensure that the broader economic system works for low-income people and communities.